United States Court of Appeals

for the Second Circuit

PETITION FOR REHEARING

ORIG.

75-7108

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

PIERRE J. LELANDAIS & CO., INC., PIERRE J. LELANDAIS, RESEARCH & SCIENCE INVESTORS, INC., INTERCONTINENTAL TECHNOLOGY & NATIONAL RESOURCES, CORONET FUND and CREATIVE CAPITAL FUND,

Plaintiff-Appellees; Cross-Appellants,

vs.

MDS-ATRON, INC. and MOHAWK DATA SCIENCES CORP.,

Defendants-Appellants,

and

JOSEPH S. STOUTENBURGH and RICHARD L. KARPEN,

Defendants.

On Appeal from the United States District Court

For the Southern District of New York

PETITION OF PLAINTIFFS (APPELLEES AND CROSS-APPELLANTS) FOR REHEARING

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PETITION OF PLAINTIFFS (APPELLEES AND CROSS-APPELLANTS) FOR REHEARING

Preliminary Statement

Plaintiffs-appellees hereby petition this Court for rehearing of so much of its judgment and decision of May 5, 1976, as declined to remand this action for further proceedings on the question of damages.

Plaintiffs were shareholders of Atron Corporation, which, on April 30, 1971, was merged into defendant MDS-Atron. The district court held that the proxy statement

by which the merger was accomplished was materially false and misleading, and it therefore awarded damages in the amount of $164,431.40.

Defendants appealed, and this Court reversed, holding that no actual damages had been proved.

Plaintiffs urge rehearing in the belief that it would be just and fair to permit them an opportunity to prove damages in accordance with this Court's decision. For the reasons hereinafter specified, denial of such an opportunity would work an extremely harsh result, against the defrauded parties, to the benefit of the defrauder.

Question Presented

Where the district court found that plaintiffs had been damaged in the amount of $164,431 by virtue of a fraudulent proxy statement, but this Court determined that the proper method had not been employed in computing damages, would it be just and equitable to direct further proceedings on the question of damages?

POINT

IN VIEW OF THE DEARTH OF PRECEDENT, THE COMPLEXITY OF THE ISSUE, THE FAVORABLE FINDINGS OF THE DISTRICT COURT, AND THE BASIC TENET OF "A REMEDY FOR A WRONG", THE MOST EQUITABLE RESULT IN THIS CASE WOULD BE TO REMAND FOR FURTHER PROCEEDINGS REGARDING DAMAGES

A. Plaintiffs did not "decline" to prove damages. In its decision this Court states that plaintiffs "declined" to prove actual damages. This is incorrect. In retrospect, plaintiffs simply chose, and asserted, a theory of damage computation which this Court found to be inappropriate. It was plaintiffs' legal contention that their damages were the difference between the market price of their stock on the day of the merger and the proceeds of their subsequent sales.* Adequate proof was presented of both elements in the computation. Market price was established by Exhibit Z (791a), which showed the over-the-counter price of Atron, and by Schedule A to the pre-trial order (76a), which showed the New York Stock Exchange price of Mohawk. The proceeds of plaintiffs' sales were established by stipulated fact 37(63a).

Thus had plaintiffs' legal theory of damage computation been correct the record would contain sufficient proof of damage.

Plaintiffs did not offer proof of the "appraisal" value of their Atron stock because they did not contend, nor believe, that "appraisal" value was the proper, nor the only, basis upon which to compute damages. It was not a matter of declination. Had plaintiffs known that "appraisal"

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* Where no sales have occurred a rescissional remedy was sought.

value was the only proper computational basis they certainly would have offered the expert testimony referred to in this Court's decision. Indeed plaintiffs now seek precisely that opportunity.

Plaintiffs' purpose from the outset has been to prove and recover damages, never to decline to do so.

B. The theory of damage computation urged by plaintiffs, and that employed by the district court, were supported by applicable precedent. In Mills v. Electric Auto-Lite, 396 U.S. 375 (1970) the Supreme Court suggested that damages could be computed by awarding plaintiffs the value of that which was represented as coming to them. (388). Applying that principle to the present case, it was represented that plaintiffs had Mohawk stock coming to them, which had a New York Stock Exchange price, and therefore one acceptable remedy would be to award the price of that stock (less subsequent sale proceeds).

In Swanson v. American Consumer Industries, Inc., 475 F.2d 516 (7th Cir. 1973) a slightly different approach was taken. The court computed damages by valuing plaintiffs' stock at the value adopted by the parties in the reorganization plan. (p. 521).

The district court, in the present case, did the same

thing.* In Swanson the court clearly did not adopt an "appraisal" value method of computation. This is made clear by Judge Sprecher's dissent, in which such an approach is suggested.

However, by referencing Mills and Swanson plaintiffs are not contending that this Court erred in adopting an "appraisal" value measure of damages, rather they are contending that, prior to this Court's decision, other measures reasonably could be (and were) urged, in reliance upon existing case authority.

C. The "appraisal" value measure of damages adopted by this Court had not been announced previously. As the Court notes in the margin of its decision, Gerstle v. Gamble-Skogmo, Inc., 478 F.2d 1281 (2d Cir. 1973) is the only case in which the Second Circuit has been involved in merger-fraud damage calculations. The same footnote correctly observes that the remedy adopted in Gerstle differs from that propounded in the present decision, both in phraseology and in computational methodology. At most it is analogous.

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* In Swanson, and in the district court in the instant case, the arms-length, pre-litigation evaluation of the stock made by the defendant was considered evidence of the stock's value. In both cases defendants had, and had available to them, expertise in valuing securities. The concept employed by the courts was not purely "estoppel".

Thus, recreating the position they occupied at the time of trial, plaintiffs did not have available to them any clear guidance from this Court as to the best approach to damages. They urged an approach based on Mills, and proved all of the facts necessary to the approach they urged.

It would be a harsh result to visit plaintiffs at their peril for not foreseeing that the "appraisal" value approach to damages would be the only acceptable approach, particularly in the absence of clear precedent.

CONCLUSION

Plaintiffs proved that a wrong had been committed -- namely, use of a fraudulent proxy statement to effect a merger. Mohawk Data Sciences recently agreed to settle, for stock currently valued in excess of $4,000,000, a class action which challenged the same financial statements as were incorporated in the fraudulent proxy statement.* Although plaintiffs in the present case were within the class as defined by the class action complaint, they were excluded from the settlement (by the court, rather than by their own election), apparently because the judgment in the present case was considered an adequate remedy. There is an additional class action which has not been resolved.**

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* Gilman v. Mohawk Data Sciences Corp., SDNY, 71 Civ. 4742 CMM. See page 1 New York Law Journal, May 7, 1976.

** Oscar Gruss & Sons v. MDS-Atron, Inc., SDNY, 75 Civ. 32 KTD.

It was commenced after judgment was obtained in the present case, and its allegations are highly similar. There may be some question as to whether the plaintiffs in the present case may participate in the remaining class action. Should that question be re[illegible]ved against these plaintiffs, the result would be highl[illegible] anomalous and unfair. Every Mohawk and Atron shareholder who was damaged by Mohawk's promulgation of false financial statements would be compensated, except those very shareholders who took the lead in, and paid the cost of, exposing and proving the falsity.

In its footnote 6 this Court has suggested that no damages would be found if the proper method of calculation were employed -- "[i]t seems fairly clear that the bottom line would be negative". No such assumptions should be made. The just and equitable way to determine whether the bottom line is positive or negative is to take evidence on the issue. The bottom line could be negative only if Mohawk had agreed to pay of premium for Atron stock of some 35% to 50%. This is highly unlikely in view of the dominant bargaining position which defendants claim to have occupied in the merger negotiations. Plaintiffs respectfully submit that Mohawk will not be able to prove that the value of Atron stock was negligible, and then in the same breath, prove that it (Mohawk) acted reasonably in agreeing to buy that stock for a price far in excess of such negligible

value. In any event, this issue should be decided after an evidentiary hearing. The conclusion should not be assumed.

This Court has rejected the theory of damages asserted and proved by plaintiffs. It also has rejected the district court's computation, which accepted as evidence the defendants' evaluation of plaintiffs' stock. In place of these formulations the Court has specified what may be referred to as an "appraisal" value approach to damages. The approach previously had not been elaborated by this, or any other, Court, and it is somewhat different in methodology and emphasis from the language in Mills and Swanson.

It should be remembered that Mills accorded the district court wide latitude, in the first instance, in fashioning a remedy, and stated that there were several possibilities. (p. 389). The same latitude should be accorded in the present case. It is not uncommon for this Court to remand with instructional guidance on damages. See Chris-Craft Industries, Inc. v. Piper Aircraft Corp., 516 F.2d 172 (2d Cir. 1975).

The law of damages under §14 of the Securities Exchange Act of 1934 is in a developing stage. In addition, in such cases the district court acts with the flexibility of a court of equity, the basic tenet being to find a fair remedy where a wrong has been exposed. Given the unsettled state of the law regarding damages, and the greater justice

which would be accomplished by giving plaintiffs an opportunity to comply with the views expressed by this Court, it respectfully is requested that the decision of May 5, 1976, be modified to the limited extent of directing further district court proceedings in accordance with the decision's holdings regarding the proper measure of damages.

Plaintiffs respectfully request that this petition be considered en banc.

Respectfully submitted,

SCHWENKE & DEVINE
Attorneys for Plaintiffs

Of Counsel:

MICHAEL C. DEVINE

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

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PIERRE J. LELANDAIS & CO., INC., et al.,

Plaintiffs-Appellees; Cross-Appellants, #75-7108

-against-

MDS-ATRON, INC., et al.,

Defendants-Appellants,

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STATE OF NEW YORK)
: ss.:
COUNTY OF NEW YORK)

REBECCA G. STEINER, being duly sworn, deposes and says:

I served the attached Petition of Plaintiffs upon Paul, Weiss, Rifkind, et al., on May 19, 1976, by depositing two copies in the United States mails, postpaid, addressed to them at 345 Park Avenue, New York, New York 10022.

Rebecca G. Steiner
Rebecca G. Steiner

Sworn to before me this
19th day of May, 1976.

Michael C. Devine
Notary Public

MICHAEL C. DEVINE
Notary Public, State of New York
No. 60-0937280
Qualified in Westchester County
Certificate Filed in New York County
Commission Expires March 30, 1977